ARMOUR Residential REIT, Inc. (ARR)

Updated August 18th, 2020 by Samuel Smith

Key Metrics

Current Price:	$10	**5 Year CAGR Estimate:**	7.4%	**Market Cap:**	$609.4M
Fair Value Price:	$9.1	**5 Year Growth Estimate:**	-0.8%	**Ex-Dividend Date:**	9/14/20[1]
% Fair Value:	110%	**5 Year Valuation Multiple Estimate:**	-2.0%	**Dividend Payment Date:**	9/29/20[2]
Dividend Yield:	12.0%	**5 Year Price Target**	$8.75	**Years Of Dividend Growth:**	0
Dividend Risk Score:	F	**Retirement Suitability Score:**	B	**Last Dividend Increase:**	NA

Overview & Current Events

ARMOUR Residential (ARR) is a mortgage REIT that was formed in 2008. The trust invests primarily in residential mortgage-backed securities that are guaranteed or issued by a United States government entity including Fannie Mae, Freddie Mac and Ginnie Mae. ARMOUR has a $609 million market capitalization and produces about $165 million in annual revenue.

ARMOUR reported Q2 earnings on 7/22/20. Core income for the quarter plunged sequentially to 19 cents from 43 cents in Q1. Book value per common share remained flattish, increasing to $11.11 from $11.10 in the previous quarter. Liquidity stood at $540 million, up substantially from $360 million in Q1. During the quarter the company purchased $2.4 billion of Agency Mortgage-Backed Securities and $650 million of TBA securities.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
CF/Share	$12.52	$15.38	$12.26	$8.14	$7.06	$5.57	-$5.54	$2.78	$2.59	$2.54	***$1.30***	***$1.25***
DPS	$12.16	$11.28	$9.60	$6.48	$4.80	$3.89	$3.02	$2.28	$2.28	$2.04	***$1.20***	***$1.05***
Shares[3]	1	8	28	45	45	43	37	40	44	50	***50***	***70***

ARMOUR's cash flow has been volatile since its inception in 2008, but this is to be expected with all mREITs. Of late, a shrinking balance sheet and declining spreads have crimped the trust's ability to produce cash flow.

That being said, the economic disruption caused by the coronavirus outbreak has disrupted the business model, leading to a sharp decline in cash flow per share as well as a steep dividend cut. Moving forward, we expect the low interest rate environment and heavy government stimulus to enable the company to resume growth, though it will likely take a while for them to rebuild to previous levels of book value and earnings power.

Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/CF	5.0	3.7	4.2	3.9	4.2	3.9	---	9.3	8.6	6.7	***7.7***	***7.0***
Avg. Yld.	19%	20.0%	18.5%	20.2%	16.3%	17.9%	13.9%	8.9%	10.6%	12.0%	***12.0%***	***12.0%***

As one would expect, ARMOUR's valuation has moved around a lot in recent years. With cash flow declining of late, the valuation has moved significantly higher. Given the current uncertainty and headwinds facing the sector and the economy as a whole, we have reduced fair value further to 7 times cash flow. Given that shares trade slightly above that level based on expectation for this year's cash flow per share, we expect multiple contraction over the coming years, providing a slight headwind to total returns.

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[1] Estimate

[2] Estimate

[3] In millions

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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Safety, Quality, Competitive Advantage, & Recession Resiliency

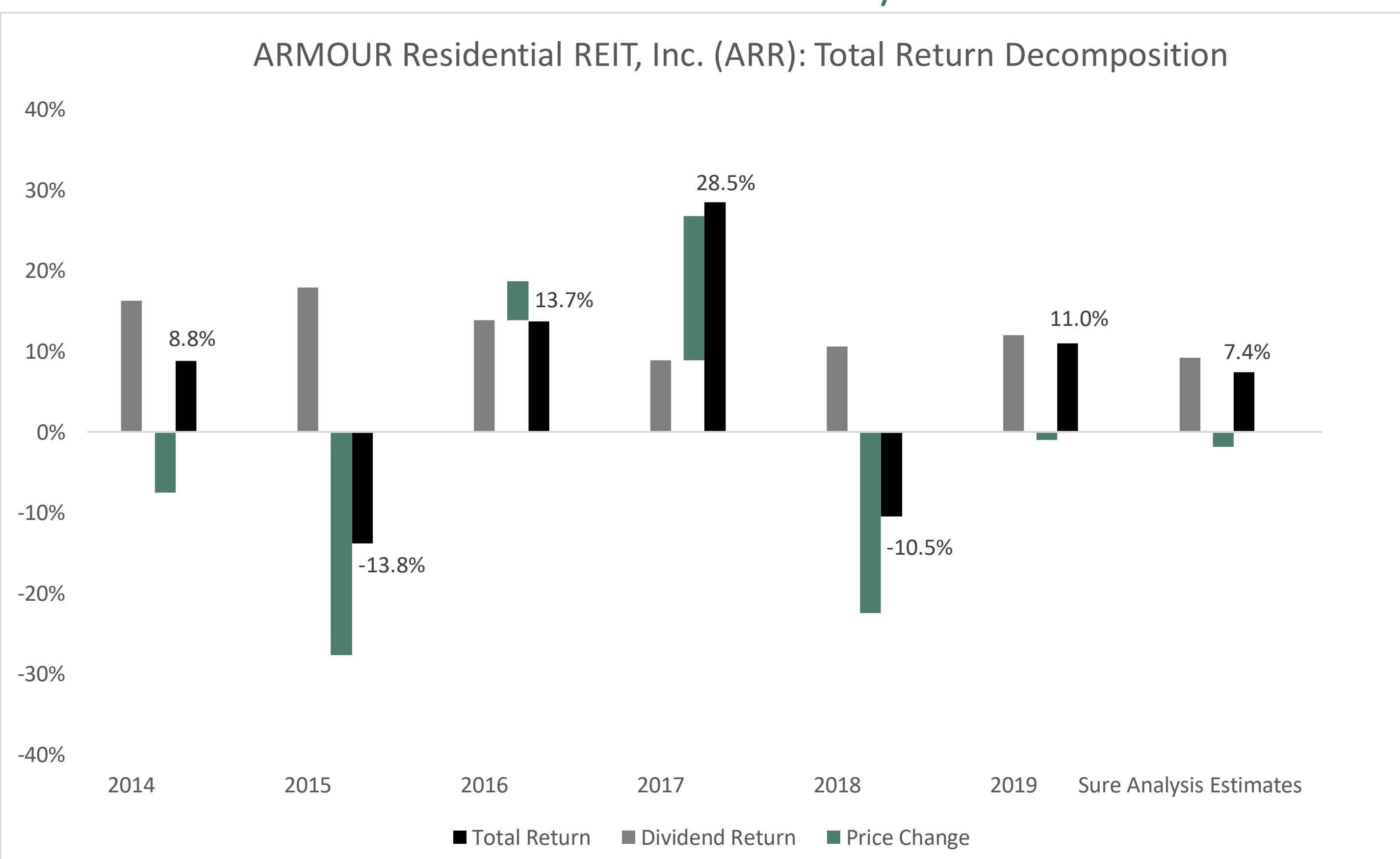
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Payout	97%	73%	78%	80%	68%	70%	---	82%	88%	80%	***92%***	***84%***

ARMOUR's quality metrics have been volatile given the performance of the trust as rates have moved around over the years. Gross margins have moved down since short-term rates began to rise meaningfully a couple of years ago, although it appears most of that damage has been done. Balance sheet leverage had been moving down slightly, but it saw an uptick again this past quarter. However, we do not forecast significant movement in either direction from this point. Interest coverage has declined with spreads but also appears to have stabilized, so we are somewhat optimistic moving forward, while keeping in mind the significant potential for volatility. ARMOUR is facing headwinds from the coronavirus outbreak and an overall economic downturn. As a result, a steep dividend cut was necessary to preserve the balance sheet and allow the REIT to reposition itself for survival and future growth.

Final Thoughts & Recommendation

In total, we see 7.4% annualized total returns for shareholders in the coming years thanks to the attractive dividend yield and an expected rebound from this year's anticipated decline. ARMOUR has endured some tough times in the past but with prudent leverage and a management team that does not chase unprofitable growth, it appears the company should be able to weather its uncertain future. We therefore rate it as a hold for aggressive investors, but not for conservative investors, and reiterate the inherent risks with mREITs.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	9	118	389	505	451	365	264	254	283	(211)
SG&A Exp.	1	9	24	35	35	33	38	36	37	34
Net Profit	7	-9	222	-187	-179	-31	-46	181	-106	(250)
Net Margin	70.5%	-8.0%	57.1%	-37.0%	-39.7%	-8.5%	-17.2%	71.2%	-37.4%	118%
Free Cash Flow	9	118	344	369	315	238	-203	110	75	(41)

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	1209	6208	20879	15733	16286	13055	7978	8929	8465	13272
Cash & Equivalents	35	252	771	496	495	290	272	265	222	181
Acc. Receivable	3	395	684	0	261	0	N/A	N/A	N/A	35
Total Liabilities	1101	5581	18571	13831	14537	11830	6886	7603	7339	11836
Accounts Payable	126	121	4	183	462	19	7	3	4	36
Long-Term Debt	0	0	0	0	0	0	0	0	0	-
Total Equity	109	627	2308	1901	1749	1225	1092	1326	1125	1,437

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	1.0%	-0.3%	1.6%	-1.0%	-1.1%	-0.2%	-0.4%	2.1%	-1.2%	-2.3%
Return on Equity	10.0%	-2.6%	15.2%	-8.9%	-9.8%	-2.1%	-3.9%	15.0%	-8.6%	-19.5%
ROIC	10.0%	-2.6%	15.2%	-8.9%	-9.8%	-2.1%	-3.9%	15.0%	-8.6%	-19.5%
Shares Out.	1	8	28	45	45	43	37	40	44	50
Revenue/Share	12.67	15.32	13.88	11.14	10.10	8.54	7.19	6.42	6.72	(3.66)
FCF/Share	12.52	15.38	12.26	8.14	7.06	5.57	-5.54	2.78	1.79	(0.70)

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.